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December 19, 1996

Via Facsimile and Federal Express

William F. Caton, Acting Secretary
Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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DEC 20 1996

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Re: Comments on November 8, 1996, Joint Board
Recommended Decision on Universal Service Support Issues
CC Docket No. 96-45
Our File No. 8323-6734-3

Dear Mr. Caton:

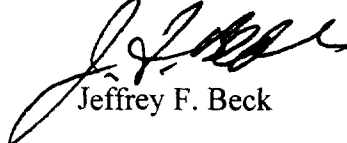
Enclosed for filing please find an original and four copies of the comments of a group of Small Western LECs in response to the November 8, 1996, Joint Board Recommended Decision on Universal Service Support Issues in the captioned docket.

Copies of this document are being mailed as directed by the FCC's Public Notice of November 18, 1996 to the service list attached to that notice. Copies are also being addressed to each Commissioner and to the International Transcription Service.

Due to the circumstance of our office being located in San Francisco, we are delivering a facsimile copy of this filing today. The original signed copy will be delivered by overnight express for inclusion in the formal file of the proceeding.

Sincerely,

BECK & ACKERMAN


Jeffrey F. Beck

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Enclosures

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**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-15

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COMMENTS

OF

**EVANS TELEPHONE COMPANY
HUMBOLDT TELEPHONE COMPANY
KERMAN TELEPHONE CO.
OREGON-IDAHO UTILITIES, INC.
PINNACLES TELEPHONE CO.
THE PONDEROSA TELEPHONE CO.
THE SISKIYOU TELEPHONE COMPANY
THE VOLCANO TELEPHONE COMPANY**

**ON NOVEMBER 8, 1996, JOINT BOARD RECOMMENDED DECISION
ON UNIVERSAL SERVICE SUPPORT ISSUES**

Dated: December 19, 1996

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CC Docket No. 96-45

The Small Western LECs are small independent local exchange carriers serving rural areas in the states of California, Nevada, Oregon, and Idaho. They are each the "carrier of last resort" providing service to residential and small business customers throughout their respective service territories, even those located in the most remote regions. As local exchange service providers in high cost areas, the Small Western LECs are directly impacted by the Commission's universal service policies and by the changes in those policies that will be required to bring them into conformance with the requirements of the Telecommunications Act of 1996 (the "1996 Act").

I. INTRODUCTION.

The November 18, 1996 Public Notice solicits comments on several issues raised by the Joint Board's Recommended Decision. These Comments will address the following two issues set forth in the Public Notice:

LEGAL AUTHORITY- What constraints exist on the Commission's legal authority to implement the Joint Board's recommendations?

COMPETITIVE NEUTRALITY- In what manner should the "additional principle" of competitive neutrality be applied consistently with the specific requirements of the 1996 Act on universal service?

The Public Notice also solicited Comments on additional issues relating to income qualification, schools/library/health care funding and jurisdictional revenue source issues. These comments will not address those subjects, since they involve policy matters beyond the experience and expertise of these commenting parties, and small, rural LECs do not necessarily require distinct treatment in these areas.

II. THE JOINT BOARD'S RECOMMENDATIONS REQUIRE MODIFICATION IN ORDER TO AVOID VIOLATING THE TELECOMMUNICATIONS ACT OF 1996.

The primary focus of the portions of the Recommended Decision that address funding in high cost areas is on the development of a new, proxy-based system for calculation of "subsidies" deemed necessary to support universal service in areas served by the BOCs and other large, geographically-diversified LECs. That issue dominated the comments and other advocacy in this docket and in the predecessor NOI and NPRM universal service proceedings in CC Docket 80-

286.

Unfortunately the battle waged by the proponents of the various proxy models and other alternative approaches seems to have diverted the attention of the Joint Board from some of the fundamental provisions of the 1996 Act pertaining to support requirements for rural areas. The 1996 Act specifically requires universal service policies that will provide customers in rural and high cost areas with access to advanced telecommunications services levels at rates deemed "comparable" to urban rates for such services. In particular Section 254 (b) of the Communications Act has been amended by the 1996 Act to require that the Commission's Universal Service policies must specifically provide for rural areas to have:

Access to advanced telecommunications and information services... [Sec. 254(b)(2)]; and

...access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. [Sec. 254(b)(3)].

It is not coincidental that these requirements for rural access standards are set forth in a statutory enactment introducing market-wide competition. They are in the 1996 Act because the Act introduces competition and, further, because competition in the absence of specific universal service rural safeguards would not maintain adequate access for high cost rural areas to the evolving services of the technological revolution in telecommunications.

A. The Proposal To Exclude Residential Service Other Than Defined Primary Lines Unreasonably Discriminates Against Rural Consumers.

The Joint Board has recommended to the Commission that the system of universal

service funding exclude allowance of support for residential second or additional lines and for any telephone service to second residences that are located in high cost areas. This recommendation, if adopted by the Commission, would violate the 1996 Act.

The Small Western LECs acknowledge that there are valid policy arguments on both sides of the issue of whether a universal service program should provide support for second lines and second homes. If the Commission were free to approach the question with a blank slate, the rationale presented by the Joint Board on this subject would be entitled to consideration. Support for second lines and for service to second homes in high-cost rural areas is not, however, an open issue under the 1996 Act. Section 254 (b) requires that those in high-cost rural areas have access to services that are comparable to those provided in urban areas and at comparable prices.

Consumers in low cost, urban areas obviously have the ability to subscribe to a second residential line at the same rate as their primary line. Owners of second homes in low-cost urban areas similarly have the ability to obtain telephone service for their second residences at today's prevailing rates. If there is no universal service support for second lines or second residences in rural areas, however, the rural consumer could well be faced with a \$15 to \$20 local rate for a primary line but a \$75 rate for a second line. The urban consumer would pay the lower rate for both lines. The customer whose second residence happened to be in a low-cost, urban area could obtain phone service for the second residence at a low rate, while the customer whose second residence was in a high-cost rural area would pay a much higher rate, unsupported by any universal service funding.

Such disparities between what rural customers pay for comparable services that are available without restriction in urban areas are flatly inconsistent with the 1996 Act's comparable

service requirement. Further, restrictions of this type, even if they were consistent with the 1996 Act, would lead to administrative difficulties in verification of status such as determining the "household" status of an applicant for service at an address already receiving service and whether a particular residence is primary or secondary. The public does not want the application for telephone service to devolve into the equivalent of an intake interview for a social service entity, but that is the direction suggested by these proposed limitations of the Joint Board.

The Joint Board's suggested limitations also ignore the obvious fact that the primary or secondary nature of a given residence will change from time to time. It makes no sense to build service facilities in rural areas that bypass a "second" residence where the unsupported cost of service would produce cost-prohibitive rates but which may upon a change in status become a primary residence and entitled to receive supported service rates. Local telephone service in high-cost rural areas is about infrastructure and permanent investment. "Now you see it now you don't" support systems will simply not do the job.

The proposal to exclude rural customers from comparable service/comparable rate treatment with respect to second lines and second homes also portends state regulatory issues of great complexity. The Small Western LECs are unaware of any local service provider in the country that charges different residential rates for second lines in rural areas or for second homes in rural areas. Is the incumbent RBOC supposed to convince its state commission that the residential rate for second lines or second homes in rural areas should be increased from \$20 to \$75 while retaining the \$20 rate for second lines and second homes in urban areas? The more likely result for the RBOC is a rate design that spreads the new universal service support on a system-wide basis, with the result that the rural customer served by the geographically-

diversified RBOC can purchase a second line or service for a second residence at a subsidized rate that reflects cross-subsidization within the large, geographically-diversified RBOC.

The small, rural LEC, however, has no options for internal cross-subsidization from low-cost areas. Its customers are more likely to be limited to a single line, thus subjecting them to discrimination not only in relation to the urban customer but also in comparison to the rural customer who happens to be served by a geographically-diversified RBOC. This discriminatory result is inconsistent with the requirements of the 1996 Act.

B. Support for Business Services Should Not Be Confined To Single Lines.

Similar issues of statutory conflict and bad public policy are presented by the Joint Board's recommendation that the Commission restrict Universal service funding for business services to single line businesses. While it is not clear whether business customers were intended to be embraced within the term "consumers" in Section 254 (b) (4) of the 1996 Act, businesses are certainly included within the requirement of subsections (1) and (2) of 254 (b), which require just, reasonable and affordable rates and nationwide access to advanced telecommunications and information services.

The end result of the Joint Board's recommendation to deny support for multi-line businesses would be unaffordably high business rates for multi-line business customers in areas served by small, rural LECs, while identically-situated businesses in the rural exchanges of the geographically-diversified RBOCs would benefit from the low rates provided by intra-company cross-subsidization, which will be kept in place due to regulatory constraints. This result is not consistent with the statute, and it does not constitute good public policy.

The Joint Board's proposal to draw the line for universal service support at single line

businesses is apparently an attempt to help out the "mom and pop" small business struggling to eke out a living in what are often very poor rural economies. The two-line business is apparently assumed to be a multi-national conglomerate, when in reality it is more likely to be just mom and pop with a fax machine.

This is an important area where the Commission's ultimate order will have significant impact on small business entities. Eliminating support for the costs of providing local telephone service to a small, rural business needing more than one telephone line can add significant operating costs and place that business at a competitive disadvantage in comparison to a similar business located in the high-cost rural exchange of a geographically-diversified RBOC. The result will be to discourage businesses from locating in rural areas served by small, rural LECs, thus further depressing their already-marginal economies. The suggestion represents bad economic, social and telecommunications policy.

If a size limitation is to be imposed by the Commission on universal service funding for small businesses in rural areas, the Small Western LECs respectfully suggest that a more appropriate cutoff point would be businesses with five lines rather than one. The provision should also allow cost recovery for the first five lines of a six line business, to avoid suppression of logical service additions to accomplish business growth. This alternative would be a substantial improvement over the Joint Board's suggestion, even though it is less advisable than simply providing comparable support to rural businesses without attempting to determine the extent of their "need" as a function of the number of telephone lines required to engage in their particular business.

C. The Proposal To Freeze Funding And To Transition To A Nonexistent Proxy Model Does Not Meet Statutory Standards.

Section 254 (b) (5) of the 1996 Act requires that universal service support be provided through mechanisms that are "specific, predictable and sufficient." The Joint Board's recommendations that USF, DEM weighting and long term CCL support currently being provided for small, rural LECs be "frozen" for a three-year period beginning in 1998 is inconsistent with this statutory requirement. The frozen level of support would be neither predictable nor sufficient.

The freeze in USF funds would ignore all cost changes subsequent to December, 1995, while the freeze in weighted DEM would incorporate only one-half of switching investment made during 1996 and none made during 1997 or later. By imposing a freeze of current funding levels, adjusted only for changes in the number of access lines, the proposal would prevent the recovery of costs that necessarily must be incurred by many companies to meet service requirements as carriers of last resort¹. That is not "sufficient" universal service funding as required by the statute.

Given the further consideration that the end of the freeze period is suggested to be a transition to a "small LEC" proxy model that does not yet exist, the only rational reaction for the small LEC is to refrain from additional investment for a period beginning in mid-1994 (when planning for 1996 outside plant construction began) until 2001, when the parameters of the anticipated small company proxy system will be known. This seven-year construction hiatus is

¹The freeze would also over-compensate carriers which are in a declining cost mode and do not need to deploy additional facilities or incur added operating costs.

recommended to be instituted by a Commission order that would be adopted in May, 1997, nearly half-way through the seven year period. That is not a "predictable" universal service funding mechanism as the statute requires.

Quite apart from the statutory requirements, the proposal to adopt a disincentive for investment by small, rural LECs, would lead to decay of rural infrastructure at a time when technology and market changes call for further investment. The "advanced" services of today and tomorrow require shorter, unloaded loop lengths and digital switching that can provide intraLATA "2-PIC" equal access, SS7 signaling and local number portability. Many rural LECs have adequate plant to meet these needs, but others will need to invest in additional facilities if their customers are to have access to the information age. A seven year construction freeze will negate the public policies that led to the adoption of the 1996 Act.

Further, there is no demonstrated need for a freeze. The idea that universal service mechanisms are somehow out of control has been debunked by actual experience with the interim cap on USF funding. For the past two years total USF funding under current rules has been less the cap limitation, which is adjusted for access line growth. Contrary to the doomsayers, USF support costs under today's mechanism are not growing at an unreasonable rate, and there is no reason to assume that allowing companies that must make added investment prior to the dawning of the new millennium to recover the cost of that investment and associated expense will lead to excessive USF cost requirements.

The statutory requirements of predictability and sufficiency also dictate caution in accepting the Joint Board's proposal that the Commission act now to adopt a transition for small LECs to proxy-based funding at a time when no actual proxy model exists that accurately

predicts investment and operating expense for the small, rural LEC. The fact that proxy models may have been developed to a level suitable for application to large LECs does not guarantee that the proxy process can be applied to a small, rural company with the degree of accuracy required by the statute.

The inevitable errors and distortions of the modeling process will tend to average out when applied to a large geographic area, but the results for a small, rural LEC will fully reflect those errors. It requires a considerable leap of faith to conclude that a model will ever be a better predictor of what it "should" cost to provide telephone service in a particular rural area than the actual experience of the serving rural LEC. The most fundamental questions such as how many miles of cable and what size cable are required to connect the customers to the central office are more likely to be correctly answered by referring to the plant records of the small LEC than by a model that makes generalized assumptions from census data. Models oversimplify and generalize about service requirements and conditions that plant engineers are required to incorporate into actual system design. Until the modelling process can be demonstrated to meet the statutory requirements of sufficiency and predictability for small, rural LECs, the present system of basing support on real costs should be retained.

Recent experience in the California PUC proceedings on proxy models referred to in the Joint Board's Recommended Decision reinforces the suggestion that the Commission should be cautious in relying on the future development of a proxy model adequate for determining small LEC investment and expense. The initial order adopted by the California Commission in December, 1995, (Decision 95-12-021) issued preliminary rules calling for all LECs, large and small, to be included in a proxy cost model for determining intrastate universal service funding.

Thereafter, evidentiary hearings were held in April-May, 1996 at which parties presented testimony and documentary evidence relative to the two models being proposed for adoption, which were the Hatfield model and Pacific Bell's CPM. Five of the LECs filing the within Comments presented evidence in those hearings that demonstrated substantial errors in both models as applied to the actual costs incurred by the small companies. Even simple and verifiable factors such as access line counts produced an error range for the Hatfield model of 20%-34% and for the CPM of 2%-90%. The Hatfield model was shown to understate loop investment by as much as 300%, and the upper range of error for both models in estimating switching investment exceeded 500%. Operating expenses and territory assignment were also incorrectly characterized by the models.

The end result of these evidentiary hearings was a reversal of the original CPUC decision to include small LECs in the proxy modeling process. The California Commission's October, 1996, Decision 96-10-066 excluded small LECs from the proxy system that was adopted for large and mid-sized LECs and their new competitors. The available models simply were not capable of doing the job. Nothing that has been presented to date should lead to the conclusion that the proxy modeling process will ever achieve the degree of precision that will render it the "sufficient and predictable" measure of universal service costs for small LECs required by the 1996 Act.

III. COMPETITIVE NEUTRALITY MAY NOT BE USED AS A RATIONALE FOR IGNORING THE CLEAR REQUIREMENTS OF THE ACT FOR RURAL UNIVERSAL SERVICE STANDARDS.

The Public Notice seeks comment on the appropriate relationship between the

“additional” principle of competitive neutrality and the Commission’s universal service policies. The answer to this question must recognize that competitive neutrality is not part of the express statutory scheme on universal service issues. As noted earlier in these comments, the 1996 Act included universal service provisions in the same statute that introduced local competition because of concerns that competition would harm universal service. Particularly the “rural safeguard” provisions of the 1996 Act were designed to protect universal service in areas served by small, rural LECs due to concern that the introduction of competition in the absence of specific rural safeguards would threaten rural service rates and service quality standards.

These considerations lead to the conclusion that competitive neutrality can only enter into the Commission’s universal service policies as a secondary consideration-- for use when the specific requirements of the 1996 Act are not compromised or threatened by consideration of the interests of competitors. It would be consistent with this approach, for example, to consider competitive neutrality in formulating policies for schools and libraries, as well as in programs for general support to low-income consumers.

Some of the Joint Board’s recommendations for rural service areas, however, attempt to introduce preferential treatment for competitors that cannot be reconciled with the requirements of the 1996 Act. One example of such a provision is the suggestion in paragraph 156 of the Recommended Decision that service area coverage requirements for eligible carriers can be met by merely “holding out” the ability to serve through advertising. This is an invitation to cream skimming by service providers who do not in fact have the ability to serve the outlying areas of a rural study area. Potential wireless service providers, for example, are likely to provide better service in a rural town and marginal or nonexistent service in outlying areas. Advertising in the

entire area is not going to lead to an actual service request being made where signal strengths are inadequate.

It is service rather than advertising that must be provided throughout the area under the statutory standard. Considering additional suggestion in paragraph 297 that an alternate provider can obtain universal service funding based on the incumbent LECs costs, the “service by advertising” standard invites marginal service providers to evade the statutory requirement of fully serving the entire study area of a rural LEC in order to be designated as an eligible carrier.

Another area in which the Joint Board’s recommendations would provide an unreasonable advantage to competitors is found in paragraphs 160-161. That discussion would allow an eligible carrier to provide service to an entire study area through a combination of its own facilities and resale. The discussion fails, however, to address the issue of receipt of universal service subsidy funding on the resold portion of the competitor’s services.

If a competitor provides service to a customer through resale, there is no possible justification for the reseller being the one who receives the subsidy for that customer. The operator of the facilities continues to bear all of the cost, and the reseller is merely purchasing the service at a discount off of the retail rate. Assume, for example, that a small, rural LEC has service costs of \$100 monthly for a customer, that the retail rate to the customer is \$20 and that the LEC is receiving \$70 monthly in USF payment for that customer. Paragraph 296 of the order and footnote 952 suggest that in order to avoid “competitive disadvantage”, a new competitor must receive the \$70 subsidy payment when it “serves” the customer through resale, despite the fact that its only service costs are a resale payment of some discount off the \$20 rate, plus billing and advertising. The Joint Board is certainly correct in its observation that “competition would

best be served” by such an arbitrage scheme, but the statutory requirement of sufficient support cannot possibly be met when the service costs are left with the incumbent and the subsidy is given to the new entrant.

Universal service programs are not supposed to create artificial incentives to competition. They are, instead, intended to support adequate rural infrastructure and service at reasonable rates in areas where competition will not provide that infrastructure and rate structure. It is not “unfair” to potential alternate service providers that the subsidy is directed to a single incumbent. It would be unreasonable to expect to support several service providers with a subsidy structure and to have the result be a ubiquitous system that would provide access facilities adequate to bring modern and full-featured service to high-cost areas. That is the statutory intent, and the Commission should be guided by the language of the 1996 Act that specifically provides advantages and protections to incumbent rural LECs that are not provided for potential competitors in their service areas.

IV. CONCLUSION.

The provisions of the 1996 Act that are particular to "Rural Telephone Companies" furnish clear guidance on universal service policy issues affecting Rural LECs. The Commission should be mindful of the need for a simple, fair and direct method of achieving the statutory goals of supporting the infrastructure necessary to maintain quality standards of service within reasonably comparable rate levels. These Comments have demonstrated several areas in which the Joint Board's recommendations are not consistent with the statutory requirements.

The statute is straightforward and understandable, and the Commission's universal service program should reflect the legislative judgment in this critical policy area.

Dated: December 19, 1996

Respectfully submitted,

EVANS TELEPHONE COMPANY
HUMBOLDT TELEPHONE COMPANY
KERMEN TELEPHONE CO.
OREGON-IDAHO UTILITIES, INC.
PINNACLES TELEPHONE CO.
THE PONDEROSA TELEPHONE CO.
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